Para Bellum Advisors

ASSET MANAGER · EQUITY HEDGE FUND (LONG-SHORT)

Equity Swap Financing Optimisation – TRS Spread Creep

SCENARIO TYPE	Asset Manager – Equity Hedge Fund (Long-Short)
ASSET CLASS	US Equities – Synthetic exposure via Total Return Swaps (multi-prime)
RISK FOCUS	Financing spread creep, counterparty pricing tier drift, hidden return drag, governance blind spots
PRIMARY OFFER	Capital Efficiency Rebuild™
RELEVANT SERVICES	TRS financing benchmarking · Prime broker RFP and repricing · Wallet-share reallocation · Multi-year spread lock · Financing governance framework

THE SITUATION

The TRS programme made sense at the time. The fund built a multi-prime total return swap stack to run a scalable long-short book with clean economics, lower operational friction than cash prime, and diversified counterparty access. Initial spreads were competitive for a mid-sized fund.

Since then, the fund evolved as intended. AUM grew, exposures rotated, and the book was managed dynamically through changing regimes. The financing did not evolve with it.

Terms were renewed annually and spreads drifted higher in small increments. Each increase was defensible in isolation. In aggregate, the programme quietly migrated from market-competitive to expensive and unmanaged. Returns were strong, AUM growth masked absolute cost creep, and financing was monitored as a percentage of NAV rather than as a spread against market. The issue only surfaced once someone looked at the swap book the way prime brokers do – through wallet share, stickiness, and pricing tier.

HOW THE DRIFT SETS IN

Multi-prime TRS programmes almost always start with competitive pricing. A broker quotes aggressively to win wallet share, then re-prices gradually at renewal. Funds typically accept small increases because the relationship feels valuable, moving swaps feels operationally painful, and each year's increment looks like market conditions.

The failure mode is not ignorance – it is governance. Pricing is reviewed opportunistically, not systematically. Benchmarking is informal rather than evidenced. Nobody owns the question: are we still paying market?

Over three to five years, a programme can drift 40 to 80 basis points without any single decision that looks wrong.

WHAT TYPICALLY BREAKS

Spread creep becomes normalised Increments of 5bp, 10bp, and 15bp accepted annually across all brokers. Each explanation sounds reasonable. The compounding does the damage – a programme drifts materially off-market without any single identifiable mistake.	**NAV growth hides the problem** Financing cost as a percentage of NAV looks stable or improved, so the fund believes it is managing cost. The unit economics – spread per notional – have materially deteriorated. The metric used for governance is the wrong one.
Wallet share dilutes negotiating leverage Three brokers each with a meaningful slice, but none with enough to fear losing the relationship. Diversification – intended to reduce dependency risk – unintentionally removed the fund's ability to extract Tier-1 pricing.	**Relationship value substitutes for competitive tension** Research, cap intro, and service are cited as offsetting value. When quantified, most of it is either redundant or not used. The smallest-share broker charges the widest spread – the classic inertia premium pattern.

THE STRUCTURAL INSIGHT

The fix was not to ask for a better spread. That rarely works. The fix was to restore negotiating power using a controlled, evidence-based process that prime brokers recognise as credible.

Market price discovery was established first – a structured request for pricing across incumbents plus credible challengers to establish a defensible clearing level. Wallet share strategy then shifted from three roughly equal relationships to a deliberate two-broker target, concentrating leverage and creating real reallocation risk.

Incumbents were forced to decide: match Tier-1 pricing for increased share, or lose allocation. Multi-year pricing commitments were then locked to prevent re-entry into the annual creep cycle.

In this case, weighted average long financing reduced by approximately 45bp – from around FF+142bp to FF+97bp. On a $1.25bn long TRS book, that translated into roughly $5-6m per annum in run-rate savings, with the largest gains from eliminating the most off-market pocket and restoring credible switching risk.

INTENDED OUTCOMES

- Financing costs reflect the fund's actual scale and switching credibility – prime broker relationships become economically intentional rather than historically inherited.
- Spread creep acquires a structural brake – pricing anchored to evidence, reviewed on a defined cadence, resistant to future drift.
- Governance moves from background overhead to explicit management – financing treated with the same discipline applied to other performance drivers.
- The fund can defend financing economics to the CIO, auditors, and allocators – not rely on relationship narratives or goodwill.
- Silent return drag removed – the compounding effect of 40-80bp spread creep over multiple years is eliminated from the base case.

WHERE THIS APPLIES

Most relevant where multi-prime TRS runs long and/or short synthetic exposure; spreads have not been benchmarked with evidence in 12 to 24 months; annual renewals happen by default without an explicit pricing mandate; AUM growth has masked absolute financing leakage; and at least one broker has small wallet share but a wide spread.

Less relevant where primes are actively re-shopped and notional reallocated as a matter of policy; the book is primarily cash prime with minimal TRS usage; TRS notionals are small enough that spreads are immaterial to net returns; or contractual multi-year pricing is already locked with credible reset terms.

TYPICAL ENGAGEMENT PATH

Capital Efficiency Rebuild™ – focused review of prime financing economics, wallet-share dynamics, and governance gaps, converting spread creep into quantified return drag and executing a pricing reset.

Secondary: Structuring-as-a-Service™ for ongoing financing governance where required.